No. 18,835

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARIA TERESA CRUZ SEGUI, as next friend on behalf of DIGNA LUZ ORTIZ, an infant and HECTOR LUIS ORTIZ, an infant,

Appellants,

vs.

RUTH SNOW BURNS O'ROURKE and JOHN P. O'ROURKE,

Appellees.

APPELLEES' BRIEF.

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APPELLEES' BRIEF.

I.

JURISDICTIONAL STATEMENT.

The jurisdictional situation in this case is very complex and must be carefully scrutinized, especially since with respect to at least one, and perhaps two, of the primary theories of recovery advanced on appeal, there would be no jurisdiction in the District Court. In addition to being complex, the situation was, and is, made confusing by the fact that the Plaintiffs-Appellants, contrary to the express requirements of FRCP 8 (a)(1), failed to make any statement in the complaint of the basis of the District Court's jurisdiction.

Defendants-Appellees, among other motions, moved in the District Court for dismissal of the complaint for lack of jurisdiction because:

> (a) Jurisdiction could not be based on diversity of citizenship (28 USCA §1332)[1] since there was not the required *complete* diversity in that plaintiffs and three of the defendants were all citizens of Puerto Rico [Tr. 18-19]. *Strawbridge v. Curtiss,* 3 Cranch 267, 2 L. Ed. 435 (U. S. 1806); Hart and Wechsler, *The Federal Courts and the Federal System,* 901 (1953); (Puerto Rico is deemed to be a *state* for purposes of determining diversity jurisdiction, 28 USCA §1332 (d)) and
>
> (b) Jurisdiction could not be based on there being a claim arising under federal law (28 USCA §1331)[2] as a claim based on a prior federal court judgment is a state created cause of action and does not provide a basis of federal jurisdiction [Tr. 20]. *Provident Safe Life Insurance Society v. Ford,* 114 U. S. 635; *Metcalf v. Watertown,* 128 U. S. 586 (1888).

Plaintiffs-Appellants recognized below that the only possible basis of jurisdiction was diversity of citizenship and, therefore, voluntarily moved for dismissal of

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[1]Section 1332. Diversity of citizenship; amount in controversy, (a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $10,000 exclusive of interest and costs, and is between: (1) Citizens of different States; . . .

[2]Section 1331. Federal question; amount in controversy. The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000 exclusive of interest and costs, and arises under the Constitution, laws or treaties of the United States.

the three non-diverse Defendants including the corporate Defendant Snow Lines, Inc. [Tr. 54] and said motion was granted [Tr. 56]. The District Court then had jurisdiction with respect to those theories of recovery urged by Plaintiffs as to which the voluntarily dismissed Defendants were not indispensable parties, and the complaint was then dismissed, not for lack of jurisdiction, but because the complaint failed to state a cause of action [Tr. 58].

In the opening brief on appeal, Plaintiffs-Appellants state that jurisdiction in the District Court was based solely on diversity of citizenship (App. Br. p. 1). If Appellants in the opening brief had restricted themselves to arguing the substantive theories of relief most strongly urged in the District Court, and as to which the voluntarily dismissed Defendants were not indispensable parties, Appellees would agree that the District Court had jurisdiction once the three Puerto Rico Defendants were dismissed, and that said jurisdiction was based on diversity of citizenship. However, in the opening brief, a theory, based upon §2202 of Chap. 112, Title 14, Private Corporations, 3A Laws of Puerto Rico (1962), is being advanced by Appellants (App. Br. p. 10) with respect to which there would be *no* jurisdiction in the District Court based on diversity of citizenship (or otherwise) for the reason that Snow Lines, Inc., one of the voluntarily dismissed and non-diverse Defendants, is an indispensable party to any claim based on said statutory theory. It is hornbook

law that where an indispensable Defendant has the same citizenship as the Plaintiffs there is no diversity of citizenship sufficient for federal jurisdiction.

> "[I]f a non-diverse party to a controversy is indispensable, *Strawbridge v. Curtiss* obviously defeats federal jurisdiction altogether. Action cannot be brought without him; and, if he is joined, an amendment to dismiss him is unaviling." *Hart and Wechsler, supra,* p. 908; *Dollar SS Lines v. Merz,* 68 F. 2d 594 (9th Cir. 1934).

That the non-diverse and voluntarily dismissed corporate defendant, Snow Lines, Inc., is an indispensable party to any claim founded on §2202 is clear from reading that section itself[3] wherein it is stated that "that the corporation, if in existence, *shall* be a party" (emphasis added). This language is mandatory and not permissive. There can be no doubt that the corporation is in existence and thus an indispensable party, regardless of appellants' frequent characterizations of it being something called "de facto dissolved".

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[3]Section 2202 of Chapter 112, Title 14, Private Corporations, 3A Laws of Puerto Rico (1962), provides as follows:

"(a) When the officers, directors or stockholders of any corporation, shall be liable to pay the debts of the corporation, or any part thereof, any action to enforce such liability shall be a class action for the benefit of all creditors *to which the corporation if in existence shall be a party.* (Emphasis added.)

"(b) No suit shall be brought against any officer, director or stockholder for any debt or liability of a corporation, of which he is an officer, director or stockholder, until judgment be obtained therefor against the corporation, nor after three years from the date of such judgment and any such officer, director or stockholder may set up any defense which the corporation might have asserted against such debt or liability. This subsection (b) shall not apply to suits brought against officers or directors of a corporation in dissolution or liquidation for maladministration of their duties under chapter 110 of this subtitle."

As a matter of fact and of record, the corporation is presently, and at all times of relevance to this action has been, fully in existence. In the judgment obtained in the District Court of Puerto Rico by these plaintiffs, which judgment is attached to and incorporated in the complaint, it is expressly so held. Finding of Fact No. 1 [Tr. 9] states that "the defendant, Snow Lines, Inc., was and now is a corporation, duly organized and *existing* under and by virtue of the laws of the Commonwealth of Puerto Rico" (emphasis added). Findings 2 and 3 [Tr. 10] recite that Snow Lines, Inc. was the owner of the vessel involved and that Snow Lines, Inc. charted, operated, managed, controlled, provisioned, manned, supplied and was in possession and control of the said vessel. Said judgment, which was obtained by *these Plaintiffs* in an action in which only they appeared, recites the existence of the corporation on December 3, 1959, the date on which the judgment was entered. Yet appellants seek to assert in their brief that the corporation was "de facto dissolved" in 1954, five years earlier. At page 3 of their brief, appellants assert that on April 1, 1954 the corporation disposed of its sole asset, the MV LEDA I. At page 4, appellants assert that *prior* to the time of the filing of the action in Puerto Rico, the corporation had disposed of all of its assets, had not engaged in any business or had any place of business, nor filed proper annual reports, and, therefore, was de facto dissolved. But, despite these statements and allegations, the District Court in Puerto Rico in Plaintiffs' own lawsuit found as a matter of fact that the corporation was in existence long *after* the alleged date of the alleged de facto dissolution.

Even in the absence of such a complete collateral estoppel against Appellants arguing lack of corporate existence, it is clear that for the purposes of Section 2202 the corporation is fully in existence. Appellants recognize at page 4 of their brief that the corporation "has never been formally dissolved by statutory proceedings as prescribed under the corporation law of Puerto Rico, nor has its legal existence expired by any limitation of its term of existence or by forfeiture". If Appellants' theory of *de facto* dissolution could be utilized to eliminate the requirement of Section 2202 that the corporation be joined as a party in this case where *the legal existence is recognized by all parties,* it would be a complete emasculation of that requirement. Section 2202 establishes a remedy, under special circumstances, against the individuals connected with a corporation where it is deemed that the normal corporate limitation of liability should not apply. In substantially all such circumstances, a case could be made out that the corporation was "non-existent" or "an alter ego" or "de facto dissolved" because those are the very situations in which such suits against officers, directors and stockholders become possible. If the theory of a so-called "de facto dissolution" would be sufficient to remove the necessity under Section 2202 for joining the corporation as a party, it would have to be found that the Puerto Rican legislature added the express requirement of joinder for no purpose. Surely, the Puerto Rican legislature was entitled to require that a corporation should at least be made a party to an action in which its very existence could be declared a fraud and which existence could be completely denied. The corporation is entitled to litigate this point. The over-

whelming presumption is that the legislature meant what it said in absolutely requiring that the corporation be joined as a party. In this regard, it should be noted that Puerto Rican Legislature has provided a means for terminating the existence of corporation which fails to comply with the Puerto Rican laws. Section 2302 of Chap. 112, Title 14, Private Corporations, 3A Laws of Puerto Rico (1962) provides for such termination through *Quo Warranto* proceedings where a corporation fails to file the necessary reports or keep required books. Plaintiffs-Appellants never availed themselves of such procedure and the corporation remains fully in existence.

Accordingly, to the extent that the complaint may be based on an asserted claim under Section 2202 of the Corporate Law of Puerto Rico, there is no jurisdiction in the District Court because an indispensable party Defendant, Snow Lines, Inc., is a citizen of the same state as are Plaintiffs. With respect to the Appellants' remaining theories, there is sufficient jurisdiction in the District Court under 28 USCA 1332 to find that the complaint fails to state a claim for relief. The jurisdiction of this Court is based on 28 USCA Section 1291.

II.
STATEMENT OF THE CASE.

Since the only facts that may be considered on this appeal are those set forth in the complaint, Appellees will, for the purposes of this appeal, not set forth their own statement of the case, but will make their argument based on Appellants' statement of the case.

III.
ARGUMENT.

1. Introduction.

Appellants are asserting several alternate theories in an attempt to support a claim upon which relief can be granted. These theories are alternately based on Section 2202 of the Puerto Rico Corporations Code, *supra* [see footnote 1]; on a theory of *alter ego;* on a theory of common law fraudulent conveyance; and on a theory based on Section 1804, Laws of Private Corporations, Chap. 108, Title 14, 3A Laws of Puerto Rico. None of these theories can prevail, as more fully discussed below.

2. Even Were Appellants Able to Make Out a Claim Under §2202, the District Court Would Have No Jurisdiction to Hear Such Claim; Moreover, an Indispensable Party to Any Claim Based on §2202 Has Been Dismissed From the Action.

(a) The District Court Has No Jurisdiction of Any Claim Based on §2202.

For the reasons discussed above, in the Jurisdictional Statement, this action cannot be based upon Section 2202 for the reason that the Corporation, Snow Lines, Inc., is an indispensable party Defendant and of the same citizenship as Plaintiffs and, accordingly, the District Court would have no jurisdiction.

(b) An Indispensable Party Under §2202 Has Been Voluntarily Dismissed and the Action Cannot Be Maintained in Its Absence.

Regardless of the lack of jurisdiction, the action could not be maintained under Section 2202 because the corporate Defendant, Snow Lines, Inc., was voluntarily

dismissed by Plaintiffs and, pursuant to the very terms of Section 2202, the Corporation is an indispensable party. (See the extensive discussion in the Jurisdictional Statement, *supra,* pp. 1 to 7) It is elementary that a court cannot hear an action in the absence of an indispensable party.

Of course, Appellants are in a dilemma in this regard. Because the corporation is an indispensable party, the action cannot proceed in its absence and, on the other hand, if the corporation is made a party there is no federal court jurisdiction. This is an aspect of the limited nature of the federal district court jurisdiction. The action could be brought in a state court without this dilemma, as a diversity of citizenship, of course, is not a requirement of state court jurisdiction. For a discussion of this dilemma in reference to other analogous cases, see *Hart and Wechsler, supra,* p. 908.

3. Alter Ego, Even if Established, Does Not Have the Effect Claimed by Appellants and Cannot Support the Cause of Action in This Instance; Moreover, Appellants Are Collaterally Estopped From Asserting That Doctrine.

(a) Alter Ego, Even if Established, Cannot Convert a Judgment Against One Person Into a Judgment Against Another Who Was Not a Party to That Action.

The theory of *alter ego* was the one primarily pressed in the trial court and as to which most of the papers filed below were addressed. Appellants' theory is basically this: they have a judgment against the corporation, Snow Lines, Inc.; Snow Lines, Inc. is a sham and only the *alter ego* of the individual Defendants and, accordingly, the individual Defendants should be

held liable. Assuming Appellants' facts to be correct, certain elements of this argument are plausible and give a certain apparent attractiveness to the whole theory. However, the theory contains a fatal defect. This is most clearly pointed out in the California case of *Minton v. Cavaney,* 56 Cal. 2d 576, 364 P. 2d 473 (1961). In that case, the plaintiff sued a director of a corporation on the grounds that the corporation was a sham and that he was the *alter ego.* Plaintiffs, as here, had previously obtained a judgment against the corporation. The court properly pointed out that if it was established in the lawsuit that the corporation was a sham, the defendant director would lose the limitation of liability that the corporation would normally impose and he would be left without the corporate shield. This would *permit* the director to be sued directly, but *he would have to be sued on the original cause of action,* the negligence cause of action. He cannot be sued upon the judgment as the judgment was not against him. One person cannot be sued upon the basis of a judgment against another person. This is elementary due process. United States Constitution, Article 5; Puerto Rico Constitution, Article 2, Section 7.[4] However, Appellants repeatedly make it clear that they are *not* suing on a theory of negligence but are attempting to sue upon the judgment itself (App. Br. p. 5). Appellants argue (App. Br. p. 5) that the negligence action was *merged* in a judgment which gave rise to a *new cause of*

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[4]"No person shall be deprived of his liberty or property without due process of law."

action which was brought in the court below against Appellees.

Appellants are attempting to change a sow's ear into a silk purse. A judgment against one party simply cannot be converted into a judgment against someone else. Appellants fail to distinguish between the benefits of the *alter ego* doctrine which permits them to sue Defendants based upon the original cause of action and a completely erroneous notion of due process which would permit them to sue Defendants directly upon the judgment obtained against someone else, to wit: the corporation.

The case of *Minton v. Cavaney, supra,* is a California case. However, its theory is not peculiar to California law but is based solidly on principles of due process. There appears to be no comparable case in Puerto Rico but it should be noted that Puerto Rican courts do refer to California courts for analogous authority on the *alter ego* doctrine. See *Swiggert v. Swiggert,* 55 P. R. R. 72 in which the Puerto Rican court followed California law in establishing other elements of the *alter ego* situation.

(b) Plaintiffs-Appellants Are Collaterally Estopped From Asserting That the Corporation Is a Sham and the Alter Ego of the Individual Defendants.

In their suit against the Corporation, Snow Lines, Inc., in the District Court of Puerto Rico, Plaintiffs obtained a default judgment in an action in which only they appeared and the judgment in that action is attached to and incorporated in the present complaint.

Said judgment absolutely refutes any contention that the Corporation was a sham or an *alter ego* and completely collaterally estops Plaintiffs from maintaining such a claim. The first four findings of fact in said judgment obtained by Plaintiffs are as follows [Tr. 9-10]:

> 1. The defendant, Snow Lines, Inc. was and now is a corporation, duly organized and existing under and by virtue of the laws of the Commonwealth of Puerto Rico.
>
> 2. The defendant was the owner of a certain vessel known as the M/V LEDA I.
>
> 3. The defendant chartered, operated, managed, controlled, provisioned, manned, supplied and was in possession and control of the aforesaid vessel.
>
> 4. On the 17th day of March, 1954, Genaro Ortiz Esperanza, deceased, was in the employ of the defendant and the defendant employed the decedent aboard the aforesaid vessel.

It is clear from said findings that it has been judicially decided, at Plaintiffs' own behest, that the Corporation was in existence and actually owned, operated and controlled the vessel on which the injury was alleged to have occurred and that the Corporation was the employer of the seaman. Note, particularly, the findings that the Corporation was *duly* organized *and existing* at the time of the accident and five years following at the date of judgment.

4. **Appellants' Claimed Common Law Cause of Action in the Nature of Fraudulent Conveyance Cannot Prevail as There Is No Such Common Law Doctrine in Puerto Rico and Even if There Were It Would Now Be Barred by the Statute of Limitations.**

(a) **There Is No Common Law Cause of Action in Puerto Rico—a Land Having Its Legal Orgins in the Spanish Civil Code.**

Appellants assert that common law principles will provide a basis for liability in that the Defendants caused the Corporation to improperly distribute its assets to Defendants. It is interesting that Appellants cite no Puerto Rico cases in this regard, nor do they cite Puerto Rican statutes on fraudulent conveyances.

The reason for the failure to cite Puerto Rican statutes on fraudulent conveyances is that there is nothing in the Puerto Rican law resembling the statutory codification of fraudulent conveyances as found in California and in many other states.

As to common law principles, as aforesaid, no cases are cited. As a matter of fact (and foreign law is a matter of fact to be pleaded and proved by Plaintiffs) it is doubtful that the common law exists in Puerto Rico, especially with regard to fraudulent conveyances. For example, Section 5141 of Chap. 393, Laws of Puerto Rico, Annotated, is the statutory embodiment of the basis of tort claims based on fault or negligence. Fraud is one of the subtitles covered under this statutory rubric. (See the Annotations to the above section in the Laws of Puerto Rico, Annotated). The case of *Rivera v. Central Park Opasto Viejo Incorporated,* 44 P. R. R. 236 (1932) indicates that with respect to the

the interpretation of Section 5141, the courts of Puerto Rico are not bound by common law, or by interpretations given by courts of the United States to statutes in force in the United States. The Annotations indicate that the reason for this is because Section 5141 was derived from the *Spanish Civil Code,* Art. 1902 and not from the common law.

(b) Statute of Limitations Would Have Barred Any Such Cause of Action.

Even if there were such a common law doctrine of fraudulent conveyance in Puerto Rico, which it seems apparent there is not, any cause of action based thereon would be barred by the statute of limitations.

Section 5298 of Title 31 of the Laws of Puerto Rico[5] provides that actions arising under Section 5141 (actions based on fault including fraud) must be brought within one year. This action was brought approximately eight years following the alleged fraudulent transfer. Compare California Code of Civil Procedure, Section 338[6] which bars a cause of action for fraudulent conveyance after three years. Note also that California Code of Civil Procedure, Section 361,[7] will bar

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[5]"The following prescribe in one year . . .

"2. Actions to demand civil liability for obligations arising from the fault or negligence mentioned in §5141 of this Title, from the time the aggrieved party had knowledge thereof."

[6]"Within three years: . . .

"1. An action upon a liability created by statute, other than a penalty or forfeiture. . . .

"4. An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake."

[7]§361. Limitation laws of other states, effect of. When a cause of action has arisen in another state, or in a foreign country, and by the laws thereof an action thereon cannot there

a cause of action in California as soon as it would be barred under Puerto Rican law. Thus, any cause of action based upon some alleged common law principle of fraudulent conveyance would have been barred several years ago.

5. Even Were Appellants Able to State a Claim Under §1804, That Claim Would Either Be Barred by the Statute of Limitations or Would Be One With Respect to Which the District Court Has No Jurisdiction.

Appellants assert that facts as set forth in the complaint indicate that an unlawful dividend or reduction of capital was made by the Corporation in violation of Section 1804, Puerto Rican Corporations Code[8] (App. Br. p. 20). Appellants then argue that pursuant to the combined effect of Sections 1520 and 1521, Title 14, Chap. 105 of the Laws of Puerto Rico,[9] Defendants

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be maintained against a person by reason of the lapse of time, an action thereon shall not be maintained against him in this state, except in favor of one who has been a citizen of this state, and who has held the cause of action from the time it accrued.

[8]". . . No such reduction, however, shall be made in the capital of the corporation unless the assets of the corporation remaining after such reduction are sufficient to pay any debts, the payment of which shall not have been otherwise provided for and the certificate shall so state."

[9]§1520. No corporation created under the provisions of this subtitle, nor the directors thereof, shall pay dividends upon any shares of the corporation except in accordance with the provisions of this subtitle. Dividends may be paid in cash, in property, or in shares of the capital stock, in the case of shares with par value at par, and in the case of shares without par value at such price as may be fixed by the board of directors.

§1521. In case of any willful or negligent violation of the provisions of section 1520 of this title, the directors under whose administration the same may happen shall be jointly and severally liable, *at any time within six years after paying such unlawful dividend,* to the corporation and to its creditors, in the event

are made personally liable for such improper dividends (App. Br. pp. 21-22). However, Section 1521, which provides a remedy against individual directors for a corporation's unlawfully declaring a dividend or improperly reducing its capital, expressly provides that a cause of action must be brought within six years after the payment of such unlawful dividend, or such improper reduction in capital. In this case, the alleged distribution was made in 1954 [App. Br. pp. 3-4; Tr. 46-47]. Accordingly, any action based on Sections 1804 and 1521 were barred in 1960, two years before the institution of this action.

Appellants seek to avoid this bar by arguing that in fact the statute of limitations provided in Section 2202[10] applies. If, in fact Section 2202 did apply then the statute of limitations would not have run until three years after the judgment was obtained against the Corporation and thus this action would be timely according to Appellants' argument. However even were Appellants' argument accepted in spite of the fact that Section 1521 expressly carries its own statute of limitations, this would avail Appellants nothing as Section 2202 requires that the Corporation be made a party. As more fully argued under the Jurisdictional Statement (pp. 1 to 7) and under subparagraph 2 above regarding Section 2202 (pp. 8 to 9), where said Sec-

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of its dissolution or insolvency, to the full amount of the dividend unlawfully paid, with interest on the same from the time such liability accrued. . . . (Emphasis added.)

[10]See footnote 1.

tion 2202 applies there can be no jurisdiction in the District Court because an indispensable party Defendant is missing and because that indispensable party is of the same citizenship as the Plaintiffs and would destroy jurisdiction based upon diversity of citizenship.

Conclusion.

For the reasons set forth above, the judgment of the District Court should be affirmed.

Schwab & Kant,
By Harold S. Kant,
Attorneys for Appellees.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

HAROLD S. KANT,
Attorney for Appellees.